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ABSTRACT

The financing of guarantee agencies under the U.S. Department of Education's Guaranteed Student Loan Program was reviewed to determine whether, in the aggregate, the agencies are accumulating, retaining, and using reserve funds in accordance with legislative requirements and federal regulations. It was found that reserves exceed the risks guarantee agencies are asked to assume, at the expense of the federal government and student borrowers. Recommendations are offered to the Congress and the Secretary of Education concerning: (1) the establishment of limits on the guarantee agencies' buildup of cash reserves, (2) a reduction in agencies' sources of revenues to stay within these limits, and (3) the prevention of using nonfederal funds generated by the program for other than program purposes. Appendices include: a list of guarantee agencies, descriptions of the sources and uses of guarantee agency funds, cumulative sources and uses of guarantee agency funds, cumulative sources and uses of funds for each guarantee agency as of September 30, 1985, consolidated schedule of sources and uses of funds for all guarantee agencies for federal fiscal year 1985, comparison of federal advances outstanding with reserves for each guarantee agency as of April 1986, and advance comments from the Department of Education. (SW)

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ED273183

United States General Accounting Office

GAO

Report to the Congress

July 1986

GUARANTEED STUDENT LOANS

Better Criteria Needed for Financing Guarantee Agencies

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
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GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-204708

July 2, 1986

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the financing of guarantee agencies under the Department of Education's Guaranteed Student Loan Program. The major issue in the report is our finding that reserves exceed the risks guarantee agencies are asked to assume, at the expense of the federal government and student borrowers. The report expands on our June 20, 1985, testimony on the topic before the Subcommittee on Postsecondary Education, House Committee on Education and Labor.

We are making recommendations to the Congress and the Secretary of Education concerning (1) the establishment of limits on the guarantee agencies' buildup of cash reserves, (2) a reduction in agencies' sources of revenues to stay within these limits, and (3) the prevention of using nonfederal funds generated by the program for other than program purposes.

The Consolidated Omnibus Budget Reconciliation Act of 1985 (Public Law 99-272, Apr. 7, 1986) requires the Department of Education to recall $75 million in federal advances from guarantee agencies during fiscal year 1988, based on each agency's "solvency and maturity" as determined by the Comptroller General. We currently are preparing a report to the Chairman, Subcommittee on Postsecondary Education, which will contain our suggested guidelines that the Department could use to (1) establish adequate reserve levels for guarantee agencies and (2) allow the recall of federal advances, as required, from such agencies.

We are sending copies of this report to the Secretary of Education; the Director, Office of Management and Budget; the appropriate congressional committees; each guarantee agency; and other interested parties.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Executive Summary

Purpose

Since 1965, the Guaranteed Student Loan Program has provided more than $59 billion in loans. Total loan volume during fiscal year 1985 was $8.9 billion, with federal appropriations of $3.8 billion. Administered by the Department of Education under the Higher Education Act of 1965, the program is scheduled for reauthorization in fiscal year 1986. A key issue has been the size of reserves held by the guarantee agencies that administer this program at the state level.

The objective of GAO's review was to determine whether, in the aggregate, guarantee agencies were accumulating, retaining, and using reserve funds in accordance with legislative requirements and federal regulations. This review was not designed to address the reserve funds needed on an agency-by-agency basis.

Background

Under current program regulations, students obtain loans directly from lenders. Loans are insured by a state or private, nonprofit guarantee agency and in turn reinsured by the Department of Education. If the student fails to repay (defaults), the guarantee agency reimburses the lender, and the Department in turn reimburses the agency.

Guarantee agencies fund their operations from various sources; however, the two primary sources are the student borrower and the federal government. In addition to being reimbursed for lender claims and retaining a portion of any collections, agencies are reimbursed for their administrative costs. Most agencies also hold interest-free federal advances, which are provided to strengthen reserves and help pay claims. They also may charge borrowers insurance premiums and earn interest on invested reserve funds. Under the program, "reserves" represent the cumulative surplus of funds generated by the agencies and held against contingencies.

Results in Brief

Neither the authorizing legislation, program regulations, nor operating agreements between the Department and each agency specify how much an agency should maintain in reserve. Since agencies typically have more income than expenses, the result has been a steady buildup of reserves to almost $1 billion, which, in GAO's opinion, is much larger than necessary to operate the program. The problem with this situation is that most agency funds come from either the federal government or the student borrower (in the form of insurance premiums). Thus, the buildup of reserves unnecessarily increases costs to the government or the student.

Principal Findings

Reserves Substantial Compared to Risks

In the absence of specific criteria, guarantee agencies decide for themselves what levels of reserve funds they need. In total, the agencies have accumulated reserves greater than the risks they are asked to assume. These risks are that (1) some lender claims and some operating costs may exceed reimbursements by the Department of Education and (2) some agencies may have to wait for reimbursements from the Department. During fiscal year 1985, the agencies incurred losses of $196.5 million on claims and operating costs but, due to other revenues, had a net operating surplus of $34 million. The net amount owed the agencies by the Department increased by $84.6 million during the fiscal year. But, overall, cash flow was not a problem because the agencies ended the year with $741 million in cash reserves.

While guarantee agencies need reserves, GAO believes the amount held should be related to the risks to which the agencies are exposed.

Reserves Continue to Grow

Since most expenses are reimbursed and agencies continue to generate excess funds through their operations, reserves continue to build. Although the amount of reserves varies considerably among the agencies, total reserves (including amounts owed the agencies by the Department) at the end of fiscal year 1985 were $986 million, an increase of 53 percent over fiscal year 1983.

Having taken the position that reserves are too high, the Department of Education has sought legislative action in its 1985 and 1986 budget requests to reduce certain sources of funds available to the guarantee agencies, including the return of all federal advances, which were $156 million as of April 1986. The Congress has not passed this legislation. In the Consolidated Omnibus Budget Reconciliation Act of 1985 (Public Law 99-272, Apr. 7, 1986), however, the Congress did require the Secretary of Education to recall $75 million in federal advances from the guarantee agencies during fiscal year 1988.

The Reconciliation Act requires a one-time payback. GAO believes that a more permanent solution is to amend the Higher Education Act so the recall of advances is done considering each agency's need for reserves in relation to its level of risk. Such action could result in some advances being returned in fiscal year 1987 and would eventually result in all

unneeded advances being returned. It would also curtail further reserve growth with consequent savings to the federal government.

Agencies Have Used Program Funds for Other Purposes

According to the Department, program regulations do not preclude a guarantee agency from using its reserves for purposes outside the program once the agency has repaid its federal advances. GAO found that three state agencies had spent about $25.4 million of their reserves for nonprogram purposes, such as a state grant program. How extensive this practice is nationwide is unknown, since such a determination was beyond the scope of GAO's review. In rules proposed in September 1985, but not issued in final form as of May 31, 1986, the Department would prevent the use of reserves for nonprogram purposes, regardless of whether federal advances are returned.

Recommendations

GAO recommends that the Congress amend the Higher Education Act to

- require the Secretary of Education to establish criteria for the appropriate levels of reserves for guarantee agencies and to recall all federal advances not needed to maintain such levels and
- restrict the future growth of agency reserves beyond the established levels by reducing federal subsidies and/or student costs.

GAO also recommends that the Secretary publish final regulations preventing the use of reserve funds for nonprogram purposes.

Agency Comments

The Department of Education generally agreed with GAO's recommendations, although it said setting adequate levels for reserves should await reauthorization of the Higher Education Act. The Department also cited its earlier proposals to recall all federal advances retained by guarantee agencies as a short-term means of recapturing advances without handling the complex problem of determining needed reserves agency by agency.

GAO believes that, given the potential to substantially reduce federal costs, the Department should be given the authority to establish reserve limits as soon as possible. In response to the Reconciliation Act, GAO has begun analyzing agency reserves to develop guidelines for setting adequate reserve levels (as well as a methodology for doing so). These guidelines will be available shortly and could then be adjusted to take into account any future changes in law or regulation. As noted, any

recall of advances should consider each agency's need for reserves in relation to its level of risk.

The Department also said that it is planning to issue final regulations in the near future to prevent nonprogram use of nonfederal funds generated by the program.

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Abbreviations

ACA	administrative cost allowance
FISLP	Federally Insured Student Loan Program
GAO	General Accounting Office
IGLP	Illinois Guaranteed Loan Program
OIG	Office of Inspector General
OSSC	Oregon State Scholarship Commission
PHEAA	Pennsylvania Higher Education Assistance Agency

Introduction

The Guaranteed Student Loan Program is the largest federal program providing financial assistance to students seeking a postsecondary education. Under this program, various lenders— such as commercial banks, savings and loan associations, and even state agencies—make low-interest loans to students under the protection of guarantees issued by state or private, nonprofit agencies, with reinsurance by the Department of Education.

Through the end of fiscal year 1985, the program had provided more than $59 billion in student loans. During fiscal year 1985 alone, 3.8 million students received $8.9 billion under the program.

Student Financial Aid

Student aid is provided through a myriad of loan, grant, and work study programs drawing their funding from federal, state, and other sources. The largest source is the federal government. During school year 1984-85, at least 4 of every 10 postsecondary students benefited from these federal programs, and at least 1 of every 3 dollars spent by students for their education resulted from federal aid.

In recent years, most federal aid was provided by the Department of Education, which administers six student aid programs under title IV of the Higher Education Act of 1965, as amended (20 U.S.C. 1071). These programs are Pell Grants (formerly Basic Educational Opportunity Grants), Supplemental Educational Opportunity Grants, College Work-Study, National Direct Student Loans, State Student Incentive Grants, and Guaranteed Student Loans. During 1984-85, these programs provided an estimated $14.7 billion in student aid. Federal appropriations for these six programs for fiscal year 1985 totaled an estimated $7.5 billion.

The Guaranteed Student Loan Program

This is the largest federal student aid program, providing $8.9 billion in student loans and accounting for more than half of the federal student aid during school year 1984-85. Originally intended to provide educational funds for students from low- and middle-income families, the program has changed considerably since 1965. In 1978, for example, the Congress made the program available to any qualifying student regardless of income. Due to the rapidly escalating demand for loans, however, the program was changed again in 1981 to require a needs test for students from higher income families.

The demand for loans increased dramatically during the period loans were available to all students. In fiscal year 1978, loan volume was almost $2.0 billion. By fiscal year 1981, the loan volume was over $7.8 billion, an increase of about 300 percent. Loan volume remains high, with an average annual volume over the past 4 years of $7.4 billion.

Currently, all new loans under the program are guaranteed by 58 state or private, nonprofit guarantee agencies[1] with reinsurance by the Department of Education. Previously, loans were also made under the Federally Insured Student Loan Program (FISLP) for students who did not have adequate access to guarantee agency loans. No new FISLP loans were made after July 1984; however, there is a large volume of such loans outstanding from previous years.

The current program is actually two programs. In addition to the "regular" program, responsible for 94.2 percent of the loan volume in fiscal year 1985, the Auxiliary Loans to Assist Students Program[2] assists students and parents of students who do not meet the income requirements of the regular program. Except where noted, this report concerns the regular program.

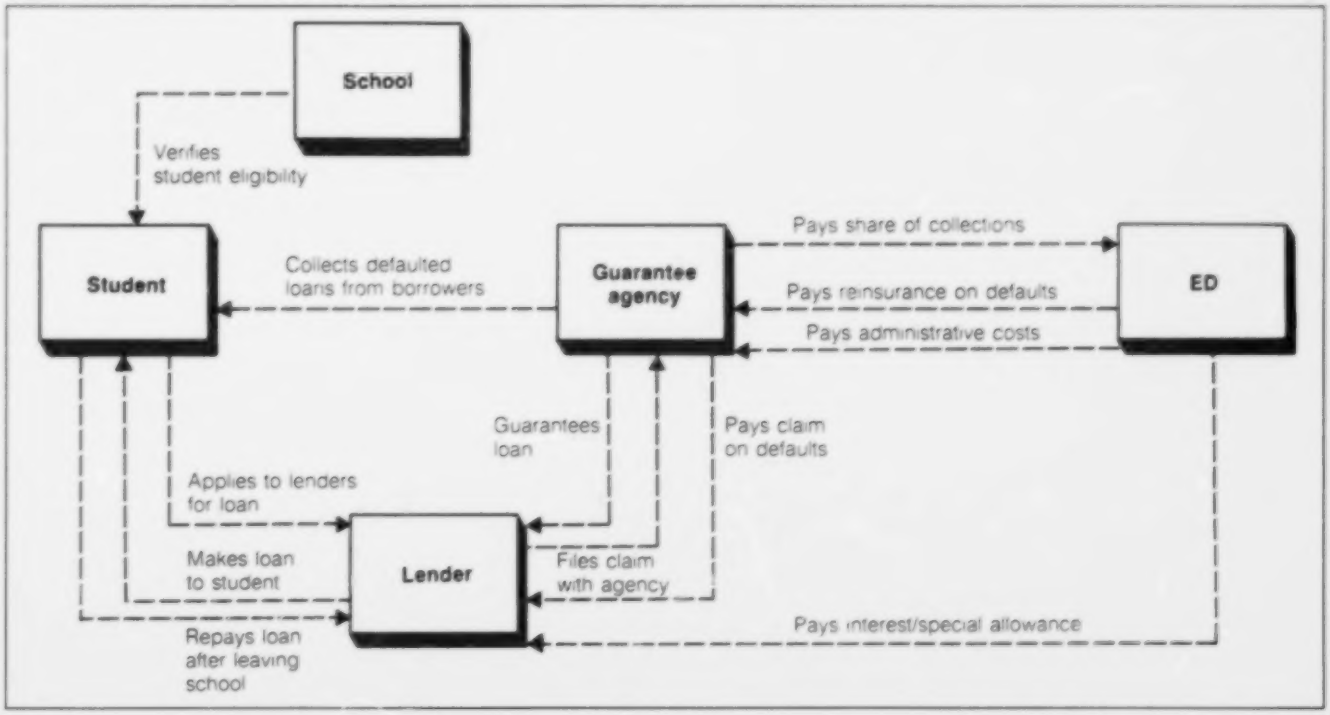
Role of Program Participants

The program involves five separate parties, each having specific duties and responsibilities. The parties are the lender, the student borrower, the student's institution of higher education, the guarantee agency, and the Department of Education. Figure 1.1, although oversimplified, shows the basic relationships among these entities:

[1]In total, 47 organizations serve as the guarantee agencies for 58 separate reporting units under the program. The number of guarantee agencies differs from the number of reporting units because two large nonprofit agencies serve as the designated guarantor for more than one state.

[2]Formerly the Parent Loans for Undergraduate Students Program.

Figure 1.1: Responsibilities of Participants in the Guaranteed Student Loan Program



The student borrower initiates the loan process. The student provides basic data to the school by which eligibility may be determined, applies to a lender for the loan, maintains student status, arranges for repayment, and actually repays the loan as it becomes due.

Lenders under the program include commercial banks, savings and loan associations, credit unions, life insurance companies, and state agencies. The lender makes the loan and, under the guarantee provisions, must exercise due diligence in making, servicing, and collecting it. This requires adherence not only to the law and program regulations, but also to any requirements established by the guarantee agency. Lenders generally bill the Department of Education directly for interest and special allowance; however, they file default claims with the guarantee agency.

The school confirms the student's original and continuing eligibility. In determining original eligibility, the school verifies that the student (1) meets either the income or needs-test requirements and (2) is not

receiving an overaward when other aid received by the student is considered. The school also may be required by the lender or guarantee agency to verify that the borrower is still in school.

The guarantee agency is responsible for administering the program within the state, encouraging program participation, and verifying that lenders exercise due diligence on all claims filed under the guarantee provisions. The agency also issues guarantees on qualifying loans. When a borrower fails to repay the loan due to death, disability, bankruptcy, or default, the guarantee agency pays the lender's claim. The agency also collects insurance premiums from lenders and attempts to collect, directly from the borrowers, loans on which the agency has paid default claims. The guarantee agency has broad authority for setting requirements for its lenders, including standards for due diligence.

The Department of Education has the authority for administering the program. This includes establishing program guidelines; approving the participation of lenders, guarantee agencies, and schools; and overseeing the operations of guarantee agencies and lenders. The Department makes interest and special allowance payments directly to lenders and makes reinsurance payments to guarantee agencies after they pay lender claims. It also reimburses the agencies for a portion of their administrative costs and provides advances to help strengthen reserves and pay lenders' claims. To partially offset program costs, the Department collects (1) origination fees collected by lenders and (2) a portion of guarantee agencies' defaulted loan collections.

Funding and Loan Volume

While funds loaned to students come from nonfederal sources (e.g., commercial banks), federal appropriations nonetheless support the program. In fiscal year 1985, total federal costs under the program were $4.1 billion, most of which was funded through federal appropriations of $3.8 billion. Some of the costs were funded by revenues from the program, including an origination fee on each loan and a portion of collections on defaulted loans.

Federal outlays under the program include payments to both lenders and guarantee agencies. Payments to lenders consist of interest and special allowance. Payments to guarantee agencies consist of reinsurance, reimbursement for administrative costs, and advances to help strengthen reserves and pay insurance claims.

Table 1.1 compares the amounts appropriated under the program with actual loan volume since the program began.

Table 1.1: Program Funding

Dollars in millions

Fiscal year	Federal appropriations	Loan volume		
		FISLP	Guarantee agency	Total
1972 and prior	$ 614	$1,830	$ 2,689	$ 4,519
1973	292	655	516	1,171
1974	399	612	528	1,140
1975	580	661	637	1,298
1976	808	740	1,088	1,828
1977	357	500	1,037	1,537
1978	480	473	1,485	1,958
1979	958	541	2,443	2,984
1980	1,609	504	4,336	4,840
1981	2,535[a]	427	7,397[a]	7,824
1982	3,074[a]	234	6,004[a]	6,238
1983	3,101[a]	134	6,794[a]	6,928
1984	2,257[a]	41	7,875[a]	7,916
1985	3,800[a]	0	8,884[a]	8,884
Total	**$20,864**	**$7,352**	**$51,713**	**$59,065**

[a]Includes Auxiliary Loans to Assist Students.

Loan volume increased substantially in recent years. One reason is the increase in the number of students receiving loans. In 1977, for example, 973,000 loans were made. In 1981, 3.5 million students—nearly four times the 1977 level—received loans. Since 1981, the number of loans has averaged over 3 million per year, including an estimated 3.8 million in fiscal year 1985.

Another factor influencing the increase in overall loan volume is the steady increase in the average amount of a loan. In 1973, for example, the average loan amount was $1,137. By 1985, the average loan had increased to $2,324—more than double the 1973 average.

Role of the Guarantee Agency

The guarantee agency is the "middleman" of the Guaranteed Student Loan Program, serving as the link between the Department of Education and the lender and administering the program at the state and local levels. In essence, the guarantee agency carries out the same guarantor

functions that the Department of Education performed under FISLP. A listing of current guarantee agencies is included in appendix I.

Agency Functions

All guarantee agencies perform certain key functions as required by law and regulation. The agency (1) insures loans made by lenders, (2) pays lender claims when borrowers fail to repay, (3) attempts to collect defaulted loans on which it has paid claims, and (4) promotes lender participation. In carrying out these functions, the guarantee agency performs numerous related tasks, such as providing assistance to lenders trying to collect loans about to go into default (called preclaims assistance), verifying lender due diligence on claims paid, and determining the continuing eligibility of borrowers not yet in repayment. The agency works with lenders, students, and schools and may contract with other organizations to perform its duties.

The guarantee agency may perform other functions related to the program. Such functions include providing technical assistance and training programs for lenders and schools, monitoring the compliance of lenders and schools with program procedures, and preparing billings to the Department of Education for their lenders' interest and special allowance payments.

While agencies perform similar functions, there is no "typical" guarantee agency since each has considerable leeway in deciding how it will operate. The Department of Education requires that guarantee agencies conform to the requirements in its program regulations; however, these regulations are very broad. As an example, the Department allows each guarantee agency to accumulate reserves for various purposes but does not stipulate how large these reserves should be. Thus, agencies have broad discretion in setting their own policies.

Sources and Uses of Funds

The funds available to guarantee agencies are a mixture of federal, state, private, and agency-generated funds. Specifically, the funds come from state appropriations, federal advances, federal administrative cost allowances, insurance premiums, federal reinsurance payments, collections, investments, and other sources. These sources of funds, which are often tied to specific restrictions or eligibility requirements with which the agency must comply, are described in appendix II.

A guarantee agency's uses of funds can be subdivided into four broad categories: paying lender claims, paying operating expenses, remitting

portions of collections to the Department of Education, and other uses. These are described in appendix II.

To maintain an adequate level of working capital and to cover costs not reimbursed, guarantee agencies maintain reserves. In essence, reserves consist of the funds accumulated by an agency when its sources exceed its uses. Agencies are reimbursed for most of their expenses and tend to build sizable reserves.

Statistics on the sources, uses, and reserves for each guarantee agency are included in appendix III. In appendix IV, these statistics are shown in total for each source and use of funds.

Objective, Scope, and Methodology

The objective of this review was to determine whether guarantee agencies, in aggregate, were accumulating, retaining, and using reserve funds in accordance with legislative requirements and federal regulations. In accomplishing this objective, we developed background information related to the agencies' organization, operations, and funding.

We chose five agencies for our work. These included three state agencies—Georgia, Illinois, and Pennsylvania—and the two nationwide, private, nonprofit guarantee agencies—the Higher Education Assistance Foundation and United Student Aid Funds.

We chose the three state agencies because they (1) were established agencies, with much experience in the program and personnel familiar with various aspects of the program and its history; (2) performed most of the internal functions related to insuring loans on their own rather than using contractors; (3) were diverse concerning their relationships to other agencies operating as lenders, secondary markets, or servicing organizations; (4) were among the leaders in reserve volume; (5) provided a geographical mix; and (6) were located in different Department of Education regions. We chose the two private, nonprofit agencies because they were the only such agencies operating on a national basis at the time of our review, and they functioned as the designated guarantee agencies in seven states, four territories, and the District of Columbia.

At each agency visited, we identified and analyzed its controls over its reserve funds. This required (1) determining how the agency was organized and administered its loan insurance program within its designated location, (2) reviewing the flow of funds through the agency's program

to insure that funds were obtained and used in accordance with the law and regulations, and (3) determining what policies support the agency's development and use of reserve funds.

We accomplished our work at the guarantee agencies visited through a review of agency records, particularly those financial records supporting their quarterly reports to the Department of Education, and discussions with key agency officials. To insure the accuracy of our work, we traced the information to source documents and discussed our findings with officials of each agency.

In addition to these on-site reviews, we contacted officials of guarantee agencies in California, Connecticut, Iowa, Massachusetts, New York, Oregon, and Texas to discuss issues raised during our fieldwork. We chose these agencies because (1) they are among the larger agencies participating in the program and (2) we believed they could provide additional insights on problems encountered by agencies in establishing loan insurance programs, building reserves, and administering program funds.

We also performed work at Department of Education headquarters in Washington, D.C., and obtained information from its regional offices in Atlanta, Chicago, and Philadelphia. At headquarters, we accumulated statistics on the operations of each guarantee agency in the program, obtained copies of agreements and operating procedures, and reviewed the Department's most recent lender review reports available for the agencies visited. We held discussions with Department officials familiar with program policy, administration, and its lender reviews. Also, we discussed the results of our work at the agencies visited with Department officials.

We reviewed the program legislation and regulations and the operating agreements between the Department of Education and the guarantee agencies. We also reviewed the legislative history concerning the major changes in the program since its inception, with particular emphasis on the changes affecting guarantee agencies.

We coordinated our work with that of the Department of Education's Office of Inspector General (OIG), which has conducted a number of program reviews. We obtained information from OIG reviews involving the agencies in Connecticut, Florida, Georgia, Idaho, Louisiana, Massachusetts, New York, Oregon, Pennsylvania, Rhode Island, Tennessee, and

Wisconsin, as well as United Student Aid Funds. We also held discussions related to our specific findings with OIG officials.

We reviewed reports on the program issued by the National Commission on Student Financial Assistance, a special commission authorized by the Education Amendments of 1980 to review specific policy issues related to the title IV student aid programs. The Commission's July 1982 report on insurance premiums was particularly useful in our analysis of the sources and uses of guarantee agency funds and our preparation of appendix II.

We visited the agencies included in our review between November 1983 and July 1984. We performed follow-up work at the agencies and the Department of Education to reconcile specific questions raised during our site work. In most cases, our data are based on statistics for fiscal year 1985, the most recent year for which agency reports to the Department were available.

This review was not designed to address the amounts needed in reserve on an agency-by-agency basis. While we used examples from individual guarantee agencies to highlight certain issues and concerns, we did not attempt to project any data obtained from an individual agency to the program as a whole.

On June 20, 1985, we testified on the issue of guarantee agency reserves before the Subcommittee on Postsecondary Education, House Committee on Education and Labor, during hearings on the reauthorization of the Higher Education Act.

This review was made in accordance with generally accepted government auditing standards.

Guarantee Agency Reserve Levels Should Be Related to the Risks Assumed

Since guarantee agencies typically take in more than they spend to operate the program, reserve funds are growing. At the end of fiscal year 1985, the agencies in total held $985.7 million in reserves, a 1-year increase of 17.1 percent and a 2-year increase of 53.1 percent.

Reserves are a necessary element of the program, as agencies must guard against contingencies and cash-flow problems. Neither the authorizing legislation nor the program regulations provide guidance on the level of reserves that should be maintained, however, leaving each agency to its own determination. This has led to a steady buildup of reserves which, in the aggregate, is disproportionately high in relation to the agencies' risks, at the ultimate expense of the federal government and the student borrower.

What Are Reserves?

As commonly used by the Department of Education and the guarantee agencies, the term "reserves" refers to the reservoir of funds held by the agency for future contingencies. In fact, reserves represent those cumulative excess funds available when total expenditures are subtracted from total revenues.

The Department does not define reserves in its program regulations. According to 34 C.F.R. 682.403 and 682.404, certain sources of agency funds are to be credited to a separate account within its reserve fund. These include

- sums appropriated by a state for loan insurance purposes;
- loan insurance premiums;
- gifts, grants, or other sources;
- collections on defaulted loans, including reinsurance payments received from the Department; and
- earnings from investments of these funds.

The only source of funds not directed by the regulations to be placed in a special reserve fund is the administrative cost allowance (ACA). Technically, ACA is the Department of Education's reimbursement to the agencies for operating costs already paid from program funds. However, in administering the program, the Department considers ACA as a part of the reserve.

The Department of Education administratively considers reserves to be the cumulative surplus funds generated by an agency's operations. In the "Guarantee Agency Quarterly Report" (Form 1130), each agency

must show sources and uses of funds, with any excess shown as a reserve. Sources include insurance premiums, state appropriations, federal advances, federal reinsurance, ACA, collections, and investment earnings. Uses include claims paid, operating expenses, lender fees, and collections remitted to the Department.

On its quarterly report, the guarantee agency shows each source and use of funds for (1) the current quarter, (2) the fiscal year to date, and (3) cumulatively since the agency's program began. Any difference between sources and uses is shown as an "excess." The cumulative excess is then compared to the amount of outstanding loans subject to the agency's guarantee to compute its "reserve ratio." While the Department of Education requires this quarterly computation, it has not provided guidance for determining when either the amount in reserve or the reserve ratio has reached a satisfactory level.

The quarterly report also shows certain amounts receivable and payable, which causes total reserves to be considerably higher than cash reserves. The receivables include federal reinsurance and ACA for which the Department of Education has been billed but has not yet paid. The amounts payable include the Department's share of collections that the agency has not yet paid.

Since the reinsurance and ACA owed by the Department normally are higher than collections payable, the amounts owed the agency are more than the amounts the agency owes. For example, of the $985.7 million held in reserve by all the agencies at the end of fiscal year 1985, $244.7 million (24.8 percent) represented net amounts owed the agencies by the Department.

Reserves Are Large in Relation to Risks

Neither the authorizing legislation nor program regulations provide guidance on what constitutes an appropriate level for guarantee agency reserves. We believe, however, that since the purpose of reserves is to offset financial risks, many agencies maintain reserves greater than needed to compensate for the risks we identified. Although it was beyond the scope of this study to determine whether individual agency reserves were appropriate, in the aggregate these reserves are greater than the risks these agencies are asked to assume.

Guarantee agency reserves have increased greatly in recent years. According to the agencies' quarterly reports, reserves held by all agencies at the end of fiscal year 1985 were $985.7 million. This represents

an increase of 17.1 percent over fiscal year 1984 and 53.1 percent over fiscal year 1983.

Reserves vary considerably among the agencies, as shown in appendix III. Table 2.1 shows the 10 agencies that reported the largest reserves at the end of fiscal year 1985:

Table 2.1: Ten Guarantee Agencies With the Largest Reserves

Dollars in thousands

Agency	Total reserves	Cash reserves
New York	$129,721	$86,042
Pennsylvania	85,788	71,537
Ohio	54,813	49,700
California	51,786	18,390
Minnesota	51,596	40,552
Massachusetts	41,426	33,277
Michigan	39,813	33,385
New Jersey	37,659	24,243
Illinois	34,749	24,185
Virginia	33,489	30,578

These 10 agencies accounted for $560.8 million, or 56.9 percent, of the total reserves held by guarantee agencies at the end of fiscal year 1985. By contrast, the 10 agencies reporting the lowest reserves accounted for only $11.0 million, or about 1.1 percent, of total reserves at that time. Appendix V provides a complete summary of agency reserves.

The largest reserves are concentrated in the larger agencies and those in existence the longest. Some of the agencies, such as New York and Pennsylvania, have been in the program since 1966. Others, such as California and Minnesota, were more recently established, but have large loan volumes.

Agencies seek to increase their reserves for a number of reasons. First, a sizable reserve is a counterbalance to future contingencies. Second, some agencies say they build reserves because they believe future program funding is uncertain. Others said that high reserve levels are essential to insure lender confidence—and thus continued program participation.

Despite these reasons for building reserves, there is no consensus on how much an agency should keep in reserve. The Department of Education has not developed standards for determining when an agency has

attained an adequate reserve volume or reserve ratio, and there is little motivation for individual agencies to limit the growth of their reserves.

What Is at Risk?

In the program today, the primary factor backing a guaranteed student loan is the Department of Education's reinsurance—not the amount of an agency's reserve. In most cases, the Department provides full reinsurance; thus, any loss ultimately is borne by the Department, not the guarantee agency. Moreover, the Department reimburses agencies for their administrative costs to a large extent through ACA and the portion of collections they retain to offset collection costs. Also, if the agencies experience a shortfall, they can develop other sources of income, such as insurance premiums. With various sources of income available, agencies can, barring catastrophic circumstances, build reserves to whatever level they believe is adequate.

The risks agencies face fall into three categories:

1. Nonreimbursed claims—the possibility of reinsurance from the Department of Education at less than 100 percent.

2. Nonreimbursed operating costs—the possibility of administrative costs exceeding the maximum ACA allowed.

3. Cash flow—the need for funds to cover the time lag between when an agency incurs costs and when it receives reimbursement from the Department.

Nonreimbursed Claims

As long as an agency does not reach the reinsurance "trigger," a statutory limit on reimbursable claims explained in appendix II, the Department of Education pays the agency 100-percent reinsurance for all default claims paid. Once the agency reaches the trigger, which is tied to the volume of claims paid during the year, it receives reinsurance of 90 or even 80 percent of the claims through the remainder of the fiscal year. Thus, the risk to the agency is a maximum of 10 or 20 percent of claims paid after the reinsurance trigger is reached in any fiscal year. Reinsurance resumes at 100 percent at the beginning of the next fiscal year.

In fiscal year 1985, 21 of the 58 active agencies reached the 90-percent trigger, the earliest in March 1985 and the latest in September 1985. Only three agencies reached the 80-percent reinsurance trigger, two in

July and one in August. Thus, 37 agencies received 100-percent reinsurance for all their claims during the year. The other 21 agencies also received 100-percent reinsurance for most of the year. Overall, the average reinsurance rate for all agencies during fiscal year 1985 was 97.6 percent of claims.

Nonreimbursed Operating Costs

Administrative costs are reimbursed by either ACA or the percentage of collections retained by the agency (see app. II). ACA reimbursement may not exceed 1 percent of the amount of loans the agency guaranteed during the fiscal year in which ACA is claimed. Also, in some cases, the agency may incur costs, such as certain overhead expenses, that are not eligible for reimbursement under ACA according to program regulations, but are legitimate program costs. The existence of such costs not reimbursed by ACA exposes the agency to some risk.

Cash Flow

At any time, an agency may have funds payable to (share of collections not yet remitted) and receivable from (reinsurance for claims paid and ACA for operating costs) the Department of Education. If the amount owed by the Department is greater than the amount owed by the agency, the agency will need funds to cover this temporary shortage.

At the end of fiscal year 1985, all but 2 of the 57 guarantee agencies reporting were due amounts from the Department. As shown in appendix III, the total net amount due to the Department was $244.7 million, or 24.8 percent of the agencies' total reserves.

The Issue: Risks vs. Reserves

An agency offsets the risks described above in two ways. First, it may compensate for losses on its reimbursements through other sources of funds, such as insurance premiums, investment earnings, or state appropriations. Second, the agency has funds in reserve, generated through excess revenues in previous years.

We did not attempt to determine what amounts individual guarantee agencies require in reserve, since such amounts could fluctuate among the agencies and could require some detailed projections of future reinsurance rates, collections, and operating costs. Also, since agencies report their operating statistics on a cash basis by fiscal year, matching specific costs with federal reimbursements for these costs is not possible from the reported data. However, in aggregate terms the reserves are

large in relation to the risks. This conclusion is supported by a comparison of overall reserves and risks at the end of fiscal year 1985.

Looking at the risks associated with nonreimbursed claims and operating costs as described above, we identified a total of $196.5 million in possible losses in 1985:

- Claims paid for the year were $1,002.4 million, while reinsurance covered by the Department was $906.9 million, for a loss to the guarantee agencies of $95.5 million during the year.
- The agencies incurred nonreimbursed operating costs of $101 million. Their operating costs were $210 million for the year, while their net collections (after deducting payments to the Department) and ACA reimbursement were $109 million.

Also, while not actually a loss, the net amount the Department owed the agencies increased by $84.6 million during fiscal year 1985 (from $160.1 million to $244.7 million), which required the agencies to fund this amount for some period.

These nonreimbursed costs expose the agencies to a degree of financial risk, since they must be paid. At the same time, however, such costs are not a problem if the agencies have sufficient funds available from other sources. For example, in fiscal year 1985, the agencies in aggregate generated more than enough from other sources to cover their losses on reimbursements. To illustrate, insurance premiums, state appropriations, investment earnings, and other income provided a total of $230.5 million in revenues, which exceeded the amounts lost on reinsurance and operating expenses by $34 million.

Thus, in fiscal year 1985, the agencies generated a surplus of $34 million on their operations. Moreover, they received an additional $18.3 million in federal advances, giving a total surplus, or increase in reserves, of $52.3 million for fiscal year 1985. While we agree that the agencies need some amount to cover their cash flow, we question the need for them to retain $985.7 million in reserves—$741 million in cash reserves—when they are realizing an annual surplus on operations.

The Effect: Reserves Are Built at the Expense of the Federal Government and the Student

Based on our analysis, overall reserve levels are much higher than needed to effectively offset the risks involved in the program. What is the optimum level? Such a determination would have to be made on an agency-by-agency basis, because reserve levels and the magnitude of individual risks vary widely among the agencies.

In total, however, the guarantee agencies are generating more in revenues and retaining more in reserves than necessary to operate the program. The problem with this situation is that most agency funds come from either the federal government (in the form of advances, ACA, reinsurance, or collections retained) or the student borrower (in the form of insurance premiums). The result is (1) higher annual federal payments and/or (2) a higher cost to the student.

Action to prevent further increases in the level of reserves held by the guarantee agencies can take various forms. The first logical step, in our opinion, would be to set some ceiling on reserves and to require the return of federal advances no longer needed. Beyond this, the Congress could determine which sources of revenue to restrict, depending on the extent to which it wishes the federal government and the student to participate in financing the program.

Do Guarantee Agencies Still Need Federal Advances?

An issue closely related to the size of guarantee agency reserves is the need for federal advances. These advances, described in appendix II, make up a significant portion of many guarantee agencies' reserves. While some agencies have returned their advances, most have not, and based on our discussions with guarantee agency and Department of Education officials, there is little interest in doing so.

Table 2.2 shows the cumulative advances disbursed, repaid, and outstanding under sections 422(a) (advances to strengthen reserves) and 422(c) (advances to pay claims) for all guarantee agencies as of April 1986:

Table 2.2: Federal Advances

	422(a) advances	422(c) advances	Total advances
Disbursed	$23,863,693	$165,774,614	$189,638,307
Repaid	6,712,638	27,074,251	33,786,889
Outstanding	**$17,151,055**	**$138,700,363**	**$155,851,418**

On an agency-by-agency basis, the Department of Education's statistics on advances are somewhat misleading since all figures are shown by political subdivision, such as states and territories. In some states, another agency might have existed before the current designated agency. In the District of Columbia, for example, the former agency (now inactive except for paying claims) still has $87,485 in advances. The District's current agency (operated by the Higher Education Assistance Foundation) has repaid its advances.

Of the 57 reporting agencies by political subdivision, only 4—Massachusetts, New Jersey, Rhode Island, and Oregon—had repaid all their federal advances as of April 1986. Eighteen other agencies had made partial repayments. All repayments have been voluntary.

The agencies' outstanding federal advances range from $85,000 to more than $55.7 million. As of April 1986, three agencies each had outstanding advances of more than $10 million: California ($55.7 million), Pennsylvania ($13.9 million), and New York ($10.3 million).

Generally, agencies with the largest reserves tend to hold the largest outstanding federal advances. For example, the 10 agencies with the largest reserves at the end of fiscal year 1985 also held 58.7 percent, or about $91.5 million, of the advances outstanding as of April 1986. There are exceptions, however. For example, Massachusetts and New Jersey had $41.4 million and $37.7 million in reserves, respectively, but no federal advances. Virginia had $33.5 million in reserves, but only $168,322 in advances. A summary of advances in relation to reserves is in appendix V.

According to the Higher Education Act and program regulations, the Department of Education can ask for the repayment of section 422(a) advances when they are no longer needed. The regulations do not provide guidelines for how such a decision is to be made, but do say that the Secretary of Education may consider the "maturity and solvency of the reserve fund" and "the agency's requirements for new loan guarantees, based on its prior experience." Repayment of section 422(c) advances is required only when the total amount advanced exceeds 20 percent of an agency's outstanding loans under guarantee. Even then, repayment is required only on the advances that exceed 20 percent.

As of May 31, 1986, the Department of Education had never asked for the repayment of section 422(a) advances. Its officials could not explain why the return of these advances had not been requested, even though

they now believe several agencies no longer need them. They said returning advances had been discussed, but no decision to take action had been made. They said the Department does not have criteria for determining when these advances are no longer needed.

No agency has yet reached the point where repayment of section 422(c) advances is required because no agency's advances approach the 20-percent level. Repayment is unlikely also, according to Department of Education officials, since the growth of the program keeps the trigger point for returning the advances at a very high level. For example, the guarantee agencies had about $34 billion of outstanding student loans they had guaranteed as of the end of fiscal year 1984. Thus, the agencies, in aggregate, could have retained up to $6.8 billion (20 percent of $34 billion) in federal advances before any would be recalled.

The OIG has also concluded that advances are no longer needed. In a July 20, 1982, report, the OIG concluded that the large reserves then in existence were no longer needed due to the adequacy of the federal reimbursements. The OIG recommended that the Secretary initiate action to recover the section 422(a) advances and propose legislation to recover the section 422(c) advances.

The Department of Education now agrees that federal advances—under both sections 422(a) and (c)—are no longer needed. In its budget requests for fiscal years 1985 and 1986, the administration recommended changing the Higher Education Act to require the return of all outstanding federal advances. This change had not been enacted as of May 31, 1986.

Department of Education Concerns Over the Growth of Agency Reserves

Although the Department of Education has not developed criteria for determining when a guarantee agency's reserves are adequate, it has recently concluded that reserves have reached a sufficient level. The Department has recommended that the guarantee agencies restrict the buildup of their reserves.

In a letter to all guarantee agency directors in January 1982, the chief of the Guaranteed Student Loan Branch, Division of Policy and Program Development, pointed out that the Education Amendments of 1976—which added 100-percent reinsurance, section 422(c) advances, and ACA reimbursements—had given the agencies significant financial incentives. According to this letter, the amendments' intent was to encourage the development of new agencies as well as to strengthen the operations

of existing agencies. The letter said that "(T)hese incentives have worked well . . ." and that "virtually all guarantee agencies enjoy a surplus of income over expenses."

The letter concluded that, given this advantageous fiscal position, there was a need to reevaluate the continuing need for financial incentives:

"However, it seems clear that it was never the intent of the Congress that guarantee agencies should get 'rich' as a result of these incentives. In these days of limited funds available for educational and other social programs, it does not appear prudent to permit agencies to receive more Federal funds than needed to carry out their functions. The following table [omitted table shows six agencies with excess income over expenses of $1.3 million to $24.5 million in fiscal year 1981] provides rather dramatic evidence that agencies are currently receiving Federal dollars that are not essential to their operations."

The letter further stated:

"It is difficult for the Administration to recommend funding cuts that affect students and colleges while we continue to increase the agencies' holdings."

In its budget request for fiscal year 1985, the administration noted that all states and territories had access to guarantee agencies and that the agencies had sufficient financial resources. For these reasons and also because the administration believed the states should share more of the financial responsibility, the budget request proposed significant changes affecting guarantee agency funding. Under these proposals, the agencies would return all outstanding federal advances, the Department of Education would eliminate ACA reimbursements, and agencies would receive reinsurance at 80 percent rather than up to 100 percent.

In March 1984 testimony on its fiscal year 1985 budget request before the House Committee on Appropriations, the Department of Education supported its recommended changes by pointing to the large reserves. The Assistant Secretary for Postsecondary Education provided the following statement for the record in response to a question regarding the continuing need for advances:

"Based on data submitted by the agencies in their quarterly reports, the Department analyzed the annual and cumulative sources and uses of guarantee agency funds. This analysis indicated that, as of the end of fiscal year 1983, approximately $719 million was available in guarantee agency reserves. This amount is greater than the agencies' total operating expenditures for fiscal year 1983 and greater than their operating expenditures for fiscal years 1981 and 1982 combined.

"Although it is not possible to forecast individual agency sources and uses of funds with complete accuracy, our analysis of the impact our proposals would have had on agencies during fiscal year 1983 indicates that only three agencies . . . might have faced some financial problems. All other agencies would have had sufficient sources of income (insurance premiums, up to 30 percent of collections, investments, etc.) to cover their expenses. Furthermore, these other sources of funds would have allowed agencies to maintain a balance of reserve funds to meet any reasonable level of contingent obligations . . . ."

None of the changes recommended were made to the Higher Education Act in fiscal year 1985. The administration made similar proposals in its budget request for fiscal year 1986. The proposals provided that (1) all federal advances would be returned, (2) ACA reimbursements would be eliminated, and (3) reinsurance would be limited to a maximum of 90 percent but could be as low as 50 percent.

The Congress did not adopt the administration's proposals. It is, however, also concerned about guarantee agency financing, especially the amount of outstanding federal advances. On December 4, 1985, the House passed its bill (H.R. 3700) to reauthorize the Higher Education Act. The proposed changes would require, among other things, the return of $50 million in federal advances by the guarantee agencies. The Secretary of Education would require the return of advances, following guidelines established by the Comptroller General.

On April 7, 1986, the Consolidated Omnibus Budget Reconciliation Act of 1985 (Public Law 99-272) was enacted. One provision of the act was similar to H.R. 3700 in that it requires the Secretary of Education to recover $75 million in federal advances during fiscal year 1988. Such recoveries would be based on determinations by the Comptroller General of the solvency and maturity of individual guarantee agencies.

On June 3, 1986, the Senate passed its bill (S. 1965) to reauthorize the Higher Education Act. Like the House, the Senate proposed numerous changes to the program. Some of these—such as reductions in the reinsurance rate—eventually could influence guarantee agency reserves. Unlike the House, however, the Senate did not include a provision for the return of federal advances. As of June 30, 1986, the House and Senate had not held a conference to reconcile the two bills.

Conclusions

Guarantee agency reserves are a major issue confronting the program. At the end of fiscal year 1985, agencies had accumulated a total of $985.7 million in reserves, an increase of 17.1 percent over fiscal year

1984 and 53.1 percent over fiscal year 1983. These increases have been largely at the expense of the federal government and the student borrowers, the parties that ultimately finance the program.

We believe that the total level of reserves exceeds what is needed to meet the risks the guarantee agencies are asked to assume. The problem is that, while our analysis of the available data support our conclusion for the program as a whole, corrective action must address the needs of individual agencies. Thus, before any changes can take place, the Department of Education must decide what levels of reserves the agencies require. Once such levels are established, new procedures for returning federal advances and restricting income into the reserves are needed. Since these limitations on income address the issue of who finances the program, we believe these decisions should be made by the Congress.

The current provisions in H.R. 3700 and the Reconciliation Act to require the return of federal advances are consistent with our conclusion, as such advances would be returned when they are no longer necessary. However, this is only the first step. Reserves will continue to grow unless income into the reserve funds is restricted. The Congress has numerous options available to limit such growth. If the Congress wishes to reduce federal funding, it can do so by reducing (1) ACA reimbursements, (2) the amount of collections retained by agencies, or (3) the level of reinsurance. If the Congress wishes to reduce costs to student borrowers, it could do so by requiring a reduction in the insurance premium charged by agencies.

Recommendations to the Congress

We recommend that the Congress amend the Higher Education Act to require the Secretary of Education to

- establish, in consultation with the guarantee agencies, criteria for the appropriate levels of reserves guarantee agencies should retain, based on the financial risks they face, and
- recall federal advances from the guarantee agencies beyond the amounts needed to maintain reserves at the established levels.

We also recommend that the Congress amend the Higher Education Act to restrict the growth of future agency reserves beyond the established levels. In this regard, the Congress should consider adjustments to one or more of the financing provisions for guarantee agencies. Options for consideration include

- reducing ACA reimbursements, reinsurance, or the percentage of collections guarantee agencies may retain, if the preference is to reduce federal expenditures;
- reducing insurance premiums charged by agencies if the preference is to reduce student costs; or
- some combination of these.

Agency Comments and Our Evaluation

The Department of Education agreed with our recommendation that it should establish criteria for (1) determining the appropriate levels of guarantee agency reserves and (2) recalling federal advances when reserves exceed these levels. The Department stated, however, that the determination of appropriate reserve levels should await the outcome of the numerous changes in the program proposed during reauthorization proceedings and reiterated its desire to take interim measures to reduce agency reserves.

The Department also noted that the Reconciliation Act requires the Secretary of Education to recall $75 million in federal advances by fiscal year 1988, considering individual agency solvency and maturity as determined by the Comptroller General. The Department said that establishing such criteria would be difficult and noted that it therefore had proposed that all federal advances be returned in its fiscal year 1987 budget request. The Department said this proposal reflected its belief that the guarantee agencies should assume greater responsibility for financing the Guaranteed Student Loan Program.

The Department also agreed with our recommendation that the Congress consider restricting the growth of reserves by adjusting one or more of the agency financing sources provided under current law. The Department noted, for example, that it had proposed changes during reauthorization to reduce reinsurance payments, depending on each agency's default claims and collections experience.

We recognize that a final determination on reserve levels must consider changes in the Higher Education Act through reauthorization. At the same time, however, we believe that the Department should begin determining reserve needs under the program as now structured. Reserve levels could then be adjusted as program changes go into effect.

We agree with the Department that our recommendation for returning advances should be viewed in terms of the Budget Reconciliation Act. We are now developing criteria for meeting our mandate under the law

and will issue a report shortly that will provide guidelines for the Department to use in recalling the guarantee agencies' federal advances. This legislation would require the return of $75 million in advances during fiscal year 1988, depending upon the guarantee agencies' ability to do so as determined by the Comptroller General. In fact, the agencies may be able to return more than $75 million in advances during 1988, although certain agencies may need to retain their advances longer. Implementing our recommendations would eventually result in the return of all advances not needed by the agencies rather than limiting the amount to $75 million.

While we do not necessarily disagree with the Department's desire to recapture all advances (they were after all considered to be temporary in nature and to be returned when no longer needed), we believe such decisions should be based on case-by-case determinations of the reserve levels needed by individual agencies.

The proposal to reduce reinsurance rates mentioned by the Department is consistent with our recommendation to restrict reserve growth. Yet it is only one of several methods available for addressing the problem. We believe any long-range solution should consider (1) individual agency needs for reserves, (2) all sources of funds available to the agency, and (3) the role each party—the student, the federal government, and perhaps even the state—should play in funding the operation of guarantee agencies.

Program Reserves Should Be Used Only for Program Purposes

Since guarantee agency reserves are generated through the program's operations, they should be used only for program purposes. Under program regulations, however, once federal advances have been returned, the use of the funds in agency reserves is no longer restricted to program purposes. Consequently, some agencies have returned their federal advances and used reserve funds for nonprogram purposes. This has led to a situation in which, through the program, students and the federal government indirectly fund other programs or activities.

During our review, we identified instances in which three guarantee agencies had used funds for purposes other than the program. Two of the agencies were able to justify nonprogram use of the funds by first returning federal advances. In the third case, the agency's use of funds was not justified, however, and was improper under the regulations. Since such uses do not relate to the program's objectives or operations, we believe that such usage should not take place. The Department of Education agrees and has proposed regulations to prevent the use of program funds for nonprogram purposes, regardless of whether federal advances are returned.

How Are Reserves to Be Used?

The Higher Education Act does not discuss the use of reserve funds. Program regulations, rather than generally restricting the use of reserve funds at all times, restrict the use of various sources of funds, but only while federal advances are outstanding.

As discussed in chapter 2, section 422(a) advances are to be placed in a special fund in the reserve, along with (1) state appropriations for loan insurance purposes; (2) insurance premiums; (3) funds received through gift, grant, or other program purposes; (4) collections on defaulted loans, including reinsurance; and (5) amounts obtained through investment of these funds. The regulations stipulate that these funds be used only to guarantee loans, pay lender claims, refund overpayments of insurance premiums, or repay advances or reinsurance payments made by the Department of Education so long as federal funds are outstanding.

The only exceptions to these restrictions apply to insurance premiums and investment earnings of the special fund. According to the regulations, these may "be used for payments necessary for the proper administration of the guarantee agency's program." The terms "necessary" and "proper administration" are not defined; however, the regulations stipulate that insurance premiums "may not be used to provide lenders with a greater yield or for making incentive payments to lenders."

Section 422(c) advances, along with any investment earnings on them, also must be credited to a "special fund" in the reserve. These funds may be used only for paying insurance claims.

The other source of funds, ACA, is not required to be placed in a special fund. However, ACA is restricted, as the regulations specify that it is to be used for only those administrative costs not already covered by the collections retained by the agency.

Table 3.1 recaps the sources and required uses of funds generated by the guarantee agency under its loan insurance function. The sources listed represent virtually all sources of funds for the program.

Table 3.1: Sources and Uses of Agency Funds

Source	Required use
State appropriations; gifts, grants, and collections; reinsurance; section 422(a) advances	To be placed in a special reserve for use in guaranteeing loans, paying lender claims, refunding overpayments of insurance premiums, and repaying advances or reinsurance by the Department of Education
Investment earnings on above funds; insurance premiums	To be placed in reserve (same funds as section 422(a) advances) and used for any payments necessary for proper administration of the guarantee agency's program
Section 422(c) advances; investment earnings on such advances	To be placed in a special reserve for paying insurance claims
ACA	To be used only for administrative costs not covered by collections retained

Department of Education officials agreed with our general analysis of the requirements regarding the use of funds and said they were attempting to clarify many of the uncertainties about the current requirements in proposed regulations issued in September 1985. Final rules had not been issued as of May 31, 1986.

Three Agencies Have Used Reserves for Other Purposes

We identified three instances in which guarantee agencies had used reserves for other purposes. In the first case, the agency took funds from the program to aid a state grant program. In the second, the agency was placing the interest earned from the program reserves into a general state fund. In the third, the agency had transferred funds from its program account into administrative accounts related to other student aid programs managed by the same agency.

We do not know if such uses occurred in other agencies not included in our review. Our purpose here is to show that (1) the current regulations

allow guarantee agencies to use reserves for nonprogram purposes once their federal advances have been repaid and (2) the disallowance of the practice would better fulfill program objectives.

Reserves Used for State Grant Program

The guarantee agency in Oregon is the Oregon State Scholarship Commission (OSSC), a separate state agency which also administers other student aid programs within the state. One of these programs is a state grant available to needy students.

While reviewing the projected budget for the 1981-83 biennium, the governor's budget staff noted that the state did not have enough funds to meet the projected needs of the state grant program. At the same time, however, OSSC controlled the reserve fund, which, according to state officials, (1) was larger than was needed to guarantee loans and pay administrative expenses and (2) would continue to grow unless there were changes to the fund's income. Foreseeing extreme financial difficulties for Oregon over the next several years, the budget staff recommended that OSSC use program reserves to support the student grant program in 1981-83.

In October 1980, OSSC officials asked the Department of Education whether the reserve funds could be used for the state grant program if OSSC first returned federal advances. The Department responded that the return of the advances would free the reserve fund of the restrictions tied to advances in the program regulations. In essence, once OSSC returned the federal advances, the only restrictions according to the regulations would be that insurance premiums and interest earned on section 422(c) advances must be used within the program.

Based on the Department of Education's ruling, OSSC returned all $1,062,021 of its federal advances in February 1983. During the spring of 1983, OSSC used $1.5 million of its reserve funds for state grants. The Oregon legislature approved the use of an additional $1.8 million from OSSC's revenues during the 1983-85 biennium.

In March 1983, the Department of Education's OIG audited OSSC's program and questioned the use of reserve funds for nonprogram purposes. After reviewing the Department's ruling in the case, however, the OIG agreed that the regulations do not prohibit the use of reserve funds for such purposes if (1) advances are returned and (2) insurance premiums and interest on section 422(c) advances are not included in the amount used. In a May 25, 1984, letter to the Department's Assistant Secretary

for Postsecondary Education, the OIG warned of the nationwide impact that could result from the ruling in Oregon on the use of reserves. He estimated that guarantee agencies could use about $100 million in reserves for nonprogram purposes if the agencies repaid their advances.

The OIG recommended that the Department of Education expedite changes to its regulations or seek legislative action "to restrict the use of reserve funds to GSL [Guaranteed Student Loan] purposes only." Department officials agreed with this recommendation and responded that the necessary changes were being made in regulations then being rewritten. The Department issued a Notice of Proposed Rulemaking on September 4, 1985. The proposed regulations would require that all guarantee agency funds be restricted to use in administering the Guaranteed Student Loan Program, regardless of whether agencies repaid their federal advances. Final rules had not been issued as of May 31, 1986.

Interest on Reserves Retained by States

The guarantee agency in Illinois is the Illinois Guaranteed Loan Program (IGLP), a separate state agency. In accordance with state law, IGLP's reserves are maintained by the state treasurer in a common account with funds from about 300 other programs. The treasurer is responsible for all investments from the funds. During our work at IGLP, we noted that the only interest the state credited to IGLP's reserve was that earned on section 422(c) advances. The interest on the remainder of the funds was retained by the state. At the end of fiscal year 1983, IGLP had $19.7 million in reserve, $4.1 million of which was section 422(c) advances.

After we brought this matter to the attention of IGLP officials, they agreed that all the investment earnings should be included in the reserve. Consequently, the state amended its policy and began to credit the interest to the reserve beginning in March 1984. We estimate that, at current levels, the change in state policy will add at least $1.5 million a year in interest to IGLP reserves.

According to Department of Education officials, the state could not have been compelled to credit interest earned on reserves for the same reason as that presented in the Oregon case. IGLP returned its section 422(a) advances in fiscal year 1973. Accordingly, under existing regulations the only funds that are restricted to program purposes are insurance premiums and the principal and interest on section 422(c) advances. Since Illinois credited the interest for section 422(c) advances, the interest on the remainder of the reserves is not limited to the program.

Reserves Transferred to Other State Programs

The guarantee agency in Pennsylvania is the Pennsylvania Higher Education Assistance Agency (PHEAA), a public corporation that also administers other student aid programs within the state and provides services to other guarantee agencies on a contractual basis. PHEAA had the second highest reserves among guarantee agencies—more than $85.8 million at the end of fiscal year 1985.

During our review at PHEAA, we noted that the agency had transferred funds from its program reserves into general agency administrative accounts. From agency records, it was not possible to show the precise amounts credited to specific programs; however, based on PHEAA's reports to the Department of Education, we determined that the agency used $22.4 million from its reserves for nonprogram purposes.

PHEAA differed from both Oregon and Illinois in that it still had advances outstanding under sections 422(a) and 422(c) when the funds were transferred. Thus, the program regulations did not permit the use of the agency's reserves for nonprogram purposes. Agency officials justified their actions on the basis of a legal opinion from its counsel which said that it could use funds received as ACA reimbursement for nonprogram purposes. The counsel's March 9, 1981, opinion reasoned as follows:

"The Administrative Cost Allowance Account within the Loan Administrative Reserve Fund is composed of funds which have been paid to the Agency by the United States Department of Education as reimbursement for administrative expenditures previously made by the Agency in the operation of the Guaranty Loan Program. Neither state nor federal law and regulations limit or control the use of administrative cost allowances once they are paid to the Agency in reimbursement for administrative costs. Thus, the Administrative Cost Allowance Account is available for the purposes of the Agency as approved by the Board of Directors. The Board of Directors may approve the allocation of a portion of these funds as an augmentation to the Administrative Budget in the exercise of its corporate discretion.

"The foregoing opinion would apply equally to the earnings of the Administrative Cost Allowance Account and the Retention of Collections Account."

PHEAA officials also told us that they used insurance premium income to pay for administrative costs since, according to the regulations, the insurance premiums can be used for "payments necessary for the proper administration of the guarantee agency's program." When ACA attributable to these costs is received, according to the officials, the expenses have already been paid and ACA can then be used for any purpose desired.

We disagree with the agency's position. The fact that ACA payments are in the form of reimbursement does not allow the agency to ignore restrictions placed on the use of program funds. The regulations provide that the ACA payment is to be used in a certain way—i.e., as an allowance for administrative costs—and that other sources of program funds, such as insurance premiums, are to be used in certain ways—i.e., for program purposes. To the extent the agency's practice allowed ACA payments or other program funds to be transferred out of the program, we believe the agency violated the regulations.

In its Oregon ruling, the Department of Education said that the regulatory restrictions on the use of program funds continue until the agency repays the advances. PHEAA had not repaid its advances at the time it transferred the funds to nonprogram purposes, although it did return its 422(a) advances in October 1984.

We discussed this matter with PHEAA officials. They agreed to stop the practice of using program funds outside the program and to repay $22.4 million to its reserves that was transferred out in previous years. The funds were repaid on February 15, 1985.

Why Is the Use of Reserves Outside the Program a Problem?

The circumstances illustrated by the first two cases are significant because of the potential for use of reserve funds for nonprogram purposes by other agencies and because they point to underlying weaknesses in the Department of Education's program regulations. In these cases, the agencies were apparently operating within the Department's regulations. However, we and Department officials agree that the funds generated by the Guaranteed Student Loan Program should not be used as a means to support other state interests. In the third case, the state appeared to be acting contrary to the regulations.

The nonprogram use of reserves presents two major concerns. The first stems from the fact that the vast majority of agency funds come from only two sources—the student and the federal government. Thus, when reserves are not used for program purposes, an anomalous situation exists in which student borrowers and the federal government are indirectly supporting other state activities through the Guaranteed Student Loan Program.

The other major concern is that if the Department of Education permits activities similar to those in the two cases above, present reserves could be reduced by other states opting to spend their excess funds for other

purposes. This concern was voiced by the Department of Education OIG in the Oregon situation, and nationwide more than $986 million in reserves could be affected.

The Department of Education recognizes the problems of guarantee agencies using reserves for nonprogram purposes. In its September 4, 1985, Notice of Proposed Rulemaking, the Department is proposing to prevent such practices. As of May 31, 1986, these rules had not been issued in final form.

Conclusions

Program regulations are inadequate in that they have created a situation in which guarantee agencies have been allowed to use program-generated funds for nonprogram purposes. Such uses have occurred in at least two cases and, according to Department of Education officials, could take place throughout the program. The ultimate result of such uses is that the federal government and student borrowers indirectly fund other state interests through the program.

We believe that preventing the nonprogram use of guarantee agency reserve funds would better fulfill program objectives. Therefore, the Department of Education should finalize its proposed regulations to require that funds generated by an agency's loan insurance function be used only for program purposes.

Recommendation to the Secretary of Education

We recommend that the Secretary finalize the Department's proposed regulations to require that all funds received as a result of the guarantee agencies' loan insurance program be used only in support of the program.

Agency Comments and Our Evaluation

The Department of Education said that in the near future it will publish final regulations incorporating changes in the Guaranteed Student Loan Program, including limiting the use of reserves outside the program.

The Department's actions are consistent with our recommendation. However, given the potential for the guarantee agencies to expend substantial funds outside the program, we are concerned that the upcoming reauthorization might delay the issuance of rules that include preventing the nonprogram use of guarantee agencies' reserve funds. We believe that, if such delays occur, the Department should expedite

that part of the proposed regulations that would prevent the non-program use of reserve funds.

Listing of Guarantee Agencies

State	Guarantee agency
Alabama	Alabama Commission on Higher Education
Alaska	Alaska Commission on Postsecondary Education
American Samoa[a]	Pacific Islands Education Loan Program
Arizona[a]	Arizona Educational Loan Program
Arkansas	Student Loan Guarantee Foundation of Arkansas
California	California Student Aid Commission
Colorado	Colorado Guaranteed Student Loan Program
Connecticut	Connecticut Student Loan Foundation
Delaware	Delaware Guaranteed Student Loan Program
District of Columbia[b]	Higher Education Assistance Foundation
Florida	Florida Student Financial Assistance Commission
Georgia	Georgia Higher Education Assistance Corporation
Guam[a]	Pacific Islands Education Loan Program
Hawaii[a]	Hawaii Educational Loan Program
Idaho	Student Loan Fund of Idaho, Inc.
Illinois	Illinois State Scholarship Commission
Indiana	State Student Assistance Commission of Indiana
Iowa	Iowa College Aid Commission
Kansas[b]	Higher Education Assistance Foundation
Kentucky	Kentucky Higher Education Assistance Authority
Louisiana	Governor's Special Commission on Educational Services
Maine	Maine Guaranteed Student Loan Program
Maryland	Maryland Higher Education Loan Corporation
Massachusetts	Massachusetts Higher Education Assistance Corporation
Michigan	Michigan Department of Education; Michigan Higher Education Assistance Authority
Minnesota[b]	Higher Education Assistance Foundation
Mississippi	Mississippi Guarantee Student Loan Agency—Board of Trustees of State Institutions of Higher Learning
Missouri	Missouri Department of Higher Education
Montana	Montana Guaranteed Student Loan Program
Nebraska[b]	Higher Education Assistance Foundation
Nevada	Nevada Guaranteed Student Loan Program
New Hampshire	New Hampshire Higher Education Assistance Foundation
New Jersey	New Jersey Higher Education Assistance Authority
New Mexico	New Mexico Student Loan Guarantee Corporation
New York	New York State Higher Education Services Corporation
North Carolina	North Carolina State Education Assistance Authority
North Dakota	North Dakota Guaranteed Student Loan Program
Northern Marianas[a]	Pacific Islands Education Loan Program
Ohio	Ohio Student Loan Commission

State	Guarantee agency
Oklahoma	Oklahoma State Regents for Higher Education
Oregon	Oregon State Scholarship Commission
Pennsylvania	Pennsylvania Higher Education Assistance Agency
Puerto Rico	Puerto Rico Higher Education Assistance Corporation
Rhode Island	Rhode Island Higher Education Assistance Authority
South Carolina	South Carolina State Education Assistance Authority
South Dakota	South Dakota Education Assistance Corporation
Tennessee	Tennessee Student Assistance Corporation
Texas	Texas Guaranteed Student Loan Corporation
Trust Territories[a]	Pacific Islands Education Loan Program
Utah	Utah Higher Education Assistance Authority
Vermont	Vermont Student Assistance Corporation
Virginia	Virginia State Education Assistance Authority
Virgin Islands	Virgin Islands Guaranteed Student Loan Program
Washington	Washington Student Loan Guaranty Association
West Virginia[b]	Higher Education Assistance Foundation
Wisconsin	Wisconsin Higher Education Corporation
Wyoming[b]	Higher Education Assistance Foundation

[a]The United Student Aid Funds, a private, nonprofit organization, is the designated guarantee agency.

[b]The Higher Education Assistance Foundation, a private, nonprofit organization, is the designated guarantee agency.

Descriptions of the Sources and Uses of Guarantee Agency Funds

Sources

State Appropriations

State appropriations now are a relatively minor source of guarantee agency funding, although they may account for significant amounts in some states. Few agencies receive appropriations annually, and the amounts appropriated are generally small. In fiscal year 1985, state appropriations accounted for less than 1 percent of funds received from all sources.

Federal Advances

Federal advances to guarantee agencies were authorized in 3 years—1965, 1968, and 1976. The advances authorized in 1965 and 1968, under section 422(a) of the Higher Education Act, were to help establish guarantee agencies and strengthen their reserve funds against claims for defaulted loans. The 1976 advances authorized under section 422(c) of the act were to be used only for the payment of lender claims.

The advances amount to interest-free loans. The Department of Education can recall the section 422(a) advances whenever it determines they are no longer necessary to maintain an adequate reserve fund. The section 422(c) advances are to be returned only when the amount exceeds 20 percent of the agency's outstanding insurance obligation.

Most advances have not been repaid. In April 1986, $17.2 million of the $23.9 million advanced under section 422(a) and $138.7 million of the $165.8 million advanced under section 422(c) were outstanding. Thus, $155.9 million (82.2 percent) in total federal advances were still outstanding.

Administrative Cost Allowance

ACA is an amount the Department of Education pays the guarantee agencies to assist them in covering overall administrative expenses. The costs covered by ACA include those for (1) promoting lender participation, (2) collecting defaulted loans, (3) providing preclaims assistance to prevent loans from going into default, (4) monitoring student enrollment and repayment status, and (5) other activities related to the agencies' loan insurance program.

ACA is closely linked to amounts retained from collections on defaulted loans (see pp. 44 and 45). The guarantee agency is entitled to retain a portion of its collections to cover the costs generally associated with its

collection efforts. Any nonreimbursed collection costs are added with other administrative costs to determine ACA-allowable costs. The agency is entitled to bill the Department of Education for ACA in an amount equal to the lowest of either (1) ACA-allowable costs or (2) 1 percent of the amount guaranteed during the fiscal year. The 1-percent ACA limit is subdivided into a primary ACA and a secondary ACA (each 0.5 percent). The primary ACA reimburses the agencies for their qualifying administrative costs. To be eligible for reimbursement for the secondary ACA, the agencies agree to make loans to nonresident students attending school within the state. All agencies receive the primary ACA, and all except six currently receive the secondary ACA, according to a Department official.

Insurance Premiums

Most guarantee agencies collect an insurance premium from participating lenders on each new loan. The premium is normally a one-time charge discounted from the loan, collected by the lender, and paid to the guarantee agency. Each agency sets its own insurance premium, which may not exceed 1 percent per year of the unpaid principal balance of the loan. Most agencies charge from 0.5 to 1 percent per year for the number of years the student has left in school plus a grace period. In the case of a first-year student, this could equate to a premium of 2.5 to 5 percent of the loan.

The rate actually charged varies among agencies. Some agencies charge the maximum, while others charge less. An agency may charge no insurance premium at all.

According to Department of Education's regulations, an agency may use insurance premiums to make any payments necessary for the proper administration of its program. The only restriction is that the premium may not be used to provide lenders with a greater yield or to make incentive payments to lenders.

Reinsurance

Federal reinsurance payments are those payments by the Department of Education to reimburse the guarantee agencies for claims paid to lenders. From 1968 until 1976, this reinsurance was limited to 80 percent of the losses agencies incurred. Since 1976, the guarantee agencies have been able to receive up to 100-percent reinsurance.

To qualify for 100-percent reinsurance, an agency's claims in the current year must be less than 5 percent of the principal amount of loans outstanding at the close of the previous year. If the amount paid by the

Department exceeds 5 percent, the reinsurance rate drops to 90 percent for the remainder of the fiscal year. If the amount paid exceeds 9 percent, the reinsurance rate drops to 80 percent for the rest of that year. The rate reverts to 100 percent the following year and would continue at this rate until the 5- or 9-percent "trigger" is again reached.

Another requirement for an agency to receive 100-percent reinsurance is that it must be willing to guarantee loans to residents attending out-of-state schools. Otherwise the reinsurance rate is 80 percent.

While reinsurance is a source of funds (and by far the largest) for an agency, it is technically a reimbursement. Reinsurance is not received until after a claim is paid and can never exceed the amount of the claim.

Collections

Although the Department of Education reimburses the guarantee agency for each defaulted loan on which a claim has been paid, the agency retains the loan and attempts to collect from the borrower. This may be done through "in-house" collection efforts or through a collection agency.

In general, the law permits the guarantee agency to retain up to 30 percent of the amounts collected, with the remainder returned to the Department. The 30 percent can be claimed only to the extent that it offsets administrative costs of collections and preclaims assistance. Since these costs are also among those covered by ACA, the 30 percent of collections and the ACA combined cannot exceed total costs for collections and administration.

In addition to the 30 percent of collections retained, an agency is permitted to retain collections on each loan to recover amounts not reinsured. For example, an agency that received 80-percent reinsurance on a loan could retain 20 percent of collections on the loan in addition to the amounts retained to cover collection costs. Thus, the portion of collections actually retained is often greater than 30 percent.

Investments

Investment earnings are those revenues earned by investing inactive funds. The program regulations require that the agencies invest in "low-risk securities" and exercise "judgment and care" in making investments. Investment revenues are unrestricted; thus, they can be used for any program purpose. In fiscal year 1985, all agencies reported investment income.

Other Sources

Some agencies receive funds from private contributors, corporations, and even state loans. These are rare, accounting for less than 1 percent of revenues in fiscal year 1985.

Uses

Claims Paid

The largest single expenditure of a guarantee agency is for claims paid to lenders. Under the guarantee provisions, the agency reimburses the lender when a borrower fails to repay due to default, bankruptcy, death, or disability. These claims are to be paid only when the lender proves it has exercised "due diligence" in making, servicing, and attempting to collect the loan. As noted earlier, reinsurance is a reimbursement for claims paid.

Operating Expenses

Operating expenses are the costs associated with carrying out the various functions of the guarantee agency. Examples are salaries, travel, fringe benefits, computer costs, rent, lender promotion, preclaims assistance, collection costs, litigation, and consultants. The costs vary from agency to agency depending on the type and degree of services provided. The operating expenses include costs that can be reimbursed through ACA and the portion of collections retained. Any excess costs must be met by other sources of revenues, such as insurance premiums.

Collections Remitted

As noted above, the guarantee agency is responsible for collecting any loan on which it has paid a default claim. A portion of any collections is returned to the Department of Education as the "Secretary's equitable share," based on the formula established by the law.

The guarantee agency is to remit the equitable share, which according to the Department averages about 65 percent of all collections, within 60 days of its receipt of collections. The agency must be able to provide detailed records concerning the computation of the equitable share.

Other Uses

In addition to the above items, guarantee agencies occasionally report "other" uses of funds, such as repayment of federal advances, repayment of state loans, or transfers into other state accounts.

Cumulative Sources and Uses of Funds for Each Guarantee Agency as of September 30, 1985

State	Total sources	Total uses	Excess sources over uses	Net adjustments[a]	Adjusted funds available
Alabama	$ 14,071,606	$ 11,054,429	$ 3,017,177	$ 2,070,877	$ 5,088,054
Alaska	1,169,815	913,450	256,365	27,111	283,476
American Samoa	223,962	63,990	159,972	8,501	168,473
Arizona	44,501,776	43,799,395	702,381	8,562,685	9,265,066
Arkansas	17,388,223	10,325,715	7,062,508	−85,388	6,977,120
California	361,984,826	343,595,162	18,389,664	33,395,944	51,785,608
Colorado	46,173,332	32,734,812	13,438,520	3,776,953	17,215,473
Connecticut	189,449,989	181,561,179	7,888,810	4,455,126	12,343,936
Delaware	11,305,035	7,312,955	3,992,080	518,948	4,511,028
District of Columbia	46,601,268	36,644,829	9,956,439	2,011,013	11,967,452
Florida	70,444,703	60,995,745	9,448,958	8,471,309	17,920,267
Georgia	77,304,696	63,179,730	14,124,966	1,831,116	15,956,082
Guam	262,258	84,185	178,073	21,245	199,318
Hawaii	9,697,819	7,149,803	2,548,016	757,256	3,305,272
Idaho	11,059,536	9,877,934	1,181,602	555,143	1,736,745
Illinois	286,470,386	262,285,053	24,185,333	10,564,005	34,749,338
Indiana	39,736,983	26,869,278	12,867,705	3,113,593	15,981,298
Iowa	50,752,506	30,576,036	20,176,470	3,187,183	23,363,653
Kansas	80,762,975	67,362,811	13,400,164	2,738,978	16,139,142
Kentucky	32,801,641	21,811,035	10,990,606	−3,167,828	7,822,778
Louisiana	34,488,771	31,514,392	2,974,379	1,109,970	4,084,349
Maine	31,641,678	25,128,528	6,513,150	1,827,546	8,340,696
Maryland	100,257,585	83,199,412	17,058,173	10,159,698	27,217,871
Massachusetts	234,956,539	201,679,200	33,277,339	8,148,633	41,425,972
Michigan	177,311,621	143,926,147	33,385,474	6,427,939	39,813,413
Minnesota	183,523,202	142,971,004	40,552,198	11,043,785	51,595,983
Mississippi	8,621,628	6,658,784	1,962,844	991,700	2,954,544
Missouri	61,649,441	41,340,466	20,308,975	3,935,151	24,244,126
Montana	7,391,125	4,597,280	2,793,845	936,731	3,730,576
Nebraska	42,979,638	32,608,794	10,370,844	1,057,080	11,427,924
Nevada	9,944,508	8,485,719	1,458,789	308,389	1,767,178
New Hampshire	20,790,742	16,284,712	4,506,030	645,173	5,151,203
New Jersey	313,349,586	289,106,099	24,243,487	13,415,480	37,658,967
New Mexico	7,720,241	5,610,690	2,109,551	732,926	2,842,477
New York	1,077,993,306	991,951,551	86,041,755	43,679,538	129,721,293
North Carolina	37,236,803	21,510,227	15,726,576	965,133	16,691,709
North Dakota	8,699,446	4,032,623	4,666,823	533,824	5,200,647
Northern Marianas	205,180	42,277	162,903	7,040	169,943
Ohio	134,398,725	84,698,733	49,699,992	5,113,116	54,813,108

State	Total sources	Total uses	Excess sources over uses	Net adjustments[a]	Adjusted funds available
Oklahoma	$ 32,874,077	$ 26,288,348	$ 6,585,729	$485,191	$ 7,070,920
Oregon	43,731,602	35,626,254	8,105,348	1,178,592	9,283,940
Pennsylvania	667,848,519	596,311,256	71,537,263	14,250,314	85,787,577
Puerto Rico	5,650,557	2,744,445	2,906,112	1,092,537	3,998,649
Rhode Island	39,511,165	30,971,827	8,539,338	1,089,896	9,629,234
South Carolina	4,552,569	1,510,917	3,041,652	262,281	3,303,933
South Dakota	24,958,938	16,470,030	8,488,908	1,259,517	9,748,425
Tennessee	33,185,360	23,569,798	9,615,562	899,287	10,514,849
Texas	61,025,454	46,852,850	14,172,604	4,602,159	18,774,763
Trust Territories	1,078,923	1,000,093	78,830	185,423	264,253
United Student Aid Funds	97,051,568	95,466,894	1,584,674	7,167,908	8,752,582
Utah	31,122,784	23,276,567	7,846,217	168,664	8,014,881
Vermont	14,956,049	13,038,285	1,917,764	464,965	2,382,729
Virgin Islands[b]	•	•	•	•	•
Virginia	89,594,662	59,017,019	30,577,643	2,911,381	33,489,024
Washington	36,384,506	32,316,574	4,067,932	6,842,426	10,910,358
West Virginia	23,910,678	19,130,997	4,779,681	1,694,078	6,473,759
Wisconsin	182,558,829	158,202,981	24,355,848	6,075,843	30,431,691
Wyoming	4,205,096	3,189,453	1,015,643	171,977	1,187,620
Total	**$5,279,524,436**	**$4,538,528,752**	**$740,995,684**	**$244,655,061**	**$985,650,745**

[a]Reinsurance payments and ACA due from the Department of Education less portion of collections due to the Department.

[b]Data for Virgin Islands not available.

Consolidated Schedule of Sources and Uses of Funds for All Guarantee Agencies for Federal Fiscal Year 1985[a]

Dollars in thousands	Amounts
Sources:	
Insurance premiums received	$ 145,119
State appropriations received	1,662
Federal advances received	18,348
Federal reinsurance payments received	906,873
ACA received	48,401
Collections on claims paid	179,321
Investment earnings received	78,232
Other nonfederal sources	5,517
Total sources	**1,383,473[b]**
Uses:	
Claims paid	1,002,445
Operating expenses paid	168,981
Lender fees paid	7,224
Portion of collections remitted to the Department	118,664
Other uses	33,810
Total uses	**1,331,125[b]**
Excess of sources over uses	**$ 52,348[b]**

[a]Excludes Virgin Islands, for which fiscal year 1985 data were not available.

[b]Total may vary due to rounding.

Source: Guarantee agency quarterly reports as of September 30, 1985.

Comparison of Federal Advances Outstanding With Reserves for Each Guarantee Agency as of April 1986

Dollars in thousands

Agency	Cash reserves[a]	Total reserves[a]	Federal advances		
			Amount	Percent of cash	Percent of total
Alabama	$ 3,017	$ 5,088	$ 1,555	51.54	30.56
Alaska	256	283	85	33.20	30.04
American Samoa	160	168	150	93.75	89.29
Arizona	702	9,265	3,214	457.83	34.69
Arkansas	7,063	6,977	279	3.95	4.00
California[b]	18,390	51,786	55,671	302.72	107.50
Colorado	13,439	17,215	5,601	41.68	32.54
Connecticut	7,889	12,344	3,913	49.60	31.70
Delaware	3,992	4,511	417	10.45	9.24
District of Columbia[c]	9,956	11,967	87	0.87	0.73
Florida	9,449	17,920	1,494	15.81	8.34
Georgia	14,125	15,956	2,148	15.21	13.46
Guam	178	199	150	84.27	75.38
Hawaii	2,548	3,305	1,061	41.64	32.10
Idaho	1,182	1,737	335	28.34	19.29
Illinois	24,185	34,749	4,052	16.75	11.66
Indiana	12,868	15,981	2,129	16.54	13.32
Iowa	20,176	23,364	1,310	6.49	5.61
Kansas	13,400	16,139	223	1.66	1.38
Kentucky	10,991	7,823	1,729	15.73	22.10
Louisiana	2,974	4,084	1,072	36.05	26.25
Maine	6,513	8,341	619	9.50	7.42
Maryland	17,058	27,218	1,034	6.06	3.80
Massachusetts	33,277	41,426	0	•	•
Michigan	33,385	39,813	4,080	12.22	10.25
Minnesota	40,552	51,596	339	0.84	0.66
Mississippi	1,963	2,955	548	27.92	18.54
Missouri	20,309	24,244	6,448	31.75	26.60
Montana	2,794	3,731	819	29.31	21.95
Nebraska	10,371	11,428	139	1.34	1.22
Nevada	1,459	1,767	285	19.53	16.13
New Hampshire	4,506	5,151	397	8.81	7.71
New Jersey	24,243	37,659	0	•	•
New Mexico	2,110	2,842	363	17.20	12.77
New York	86,042	129,721	10,300	11.97	7.94
North Carolina	15,727	16,692	1,016	6.46	6.09
North Dakota	4,667	5,201	235	5.04	4.52
Northern Marianas	163	170	150	92.02	88.24

Agency	Cash reserves[a]	Total reserves[a]	Federal advances		
			Amount	Percent of cash	Percent of total
Ohio	$49,700	$54,813	$2,964	5.96	5.41
Oklahoma	6,586	7,071	689	10.46	9.74
Oregon	8,105	9,284	0	•	•
Pennsylvania	71,537	85,788	13,934	19.48	16.24
Puerto Rico	2,906	3,999	699	24.05	17.48
Rhode Island	8,539	9,629	0	•	•
South Carolina	3,042	3,304	747	24.56	22.61
South Dakota	8,489	9,748	2,422	28.53	24.85
Tennessee	9,616	10,515	1,403	14.59	13.34
Texas	14,173	18,775	6,437	45.42	34.28
Trust Territories	79	264	150	189.87	56.82
United Student Aid Funds	1,585	8,753	0	•	•
Utah	7,846	8,015	1,401	17.86	17.48
Vermont	1,918	2,383	574	29.93	24.09
Virgin Islands[d]	•	•	288	•	•
Virginia	30,578	33,489	168	0.55	0.50
Washington	4,068	10,910	6,042	148.53	55.38
West Virginia	4,780	6,474	191	4.00	2.95
Wisconsin	24,356	30,432	4,208	17.28	13.83
Wyoming	1,016	1,188	85	8.37	7.15
Total	**$740,996[e]**	**$985,651[e]**	**$155,851[e]**	21.03	15.81

[a]Reserves as of the end of fiscal year 1985.

[b]The comparison between revenues and advances for California is not representative. The advances include $41.3 million paid by the Department during fiscal year 1985. The state did not receive the funds by the end of the fiscal year, however, and did not report them in its reserves as of September 30, 1985.

[c]Advances are held by former agency no longer insuring new loans. The current agency is the Higher Education Assistance Foundation.

[d]Statistics for Virgin Islands not available.

[e]Totals may vary due to rounding.

Source: Guarantee agency quarterly reports for September 30, 1985; Guaranteed Student Loan Program advance funds report as of April 16, 1986.

Advance Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION

MAY 19 1986

Mr. Richard L. Fogel
Director
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

The Secretary has asked that I respond to your request for our comments on your draft report entitled, "Student Loans: Better Criteria Needed for Financing Guarantee Agencies", dated April 1986.

The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely,

C. Ronald Kimberling
Assistant Secretary

Enclosure

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202

DEPARTMENT OF EDUCATION'S RESPONSE TO GAO DRAFT AUDIT REPORT ENTITLED "STUDENT LOANS: BETTER CRITERIA NEEDED FOR FINANCING GUARANTEE AGENCIES", DATED April 18, 1986

OVERVIEW

We have completed our review of the draft audit report and concur with the recommendations of the GAO. A more detailed and concise response follows each GAO recommendation below:

GAO Recommendation #1

We recommend that the Congress amend the Higher Education Act to require the Secretary of Education to:

- establish, in consultation with the guarantee agencies, criteria for the appropriate levels of reserves guarantee agencies should retain, based on the financial risks they face; and
- recall federal advances from the guarantee agencies beyond the amounts needed to maintain reserves at the established levels.

COMMENTS

The Department generally concurs with the findings and intent of the recommendations in this report. However, the final determination of criteria for assessing appropriate levels of reserves probably should await the outcome of the many proposed changes to the program which are currently pending in Congress, and which will affect the financial risks faced by the guarantee agencies.

Furthermore, the Consolidated Omnibus Budget Reconciliation Act of 1985, enacted April 7, 1986 (Public Law 99-272), requires the Secretary to recover $75 million in Federal advances during fiscal year 1988 based on consideration of agency solvency and maturity, as determined by the Comptroller General, as well as other factors. The Department believes that the Comptroller General, with Department assistance, should begin immediately to develop a framework for assessing guarantee agency solvency and maturity in response to the current legislative authority.

However, in recognition of the difficulty in establishing specific criteria which can be applied equitably to the widely divergent operations of the guarantee agencies, and since the States and territories should assume partial financial responsibility for financing the administration of the GSL program, the Department's fiscal year 1987 budget proposes to require guarantee agencies to repay all outstanding advances in fiscal year 1987. The Department believes that an immediate recall of all outstanding advances represents the most appropriate means to address the unnecessary retention of Federal funds by the guarantee agencies.

GAO Recommendation #2

We also recommend that the Congress amend the Higher Education Act to restrict the growth of future agency reserves beyond the established levels. In this regard, Congress should consider adjustments to one or more of the financing provisions for guarantee agencies. Options for consideration include:

- reducing ACA reimbursements, reinsurance, or the percentage of collections guarantee agencies may retain, if the preference is to reduce federal expenditures; or
- reducing insurance premiums charged by agencies if the preference is to reduce student costs; or
- some combination of these which would allow both mechanisms to be used.

COMMENTS

We agree with the recommendation. It should be noted that the Administration's proposal for reauthorizing the Higher Education Act includes a number of provisions affecting guarantee agency financing, including elimination of ACA payments and changing the reimbursement rate for reinsurance payments from the current 100-90-80 percent to the 90-80-70 percent, depending upon each agency's default claims and collections experience.

GAO Recommendation #3

We recommend that the Secretary of Education promptly finalize its proposed regulations to require that all funds received as a result of the guarantee agency's loan insurance program, be used only in support of the program.

COMMENTS

The Department will publish final regulations covering this issue in the near future.

ADDITIONAL COMMENTS

We also wish to point out that the GAO draft report makes no mention of the report issued by the Office of Inspector General on July 20, 1982, entitled, "Guarantee Agencies' Reserves - Federal Advances No Longer Needed". The OIG concluded then that large reserves were no longer needed because the Federal government provides adequate funding to guarantee agencies to pay their operating and default costs. That report recommended that the Assistant Secretary for Postsecondary Education: (1) initiate action to recover the pre 1976 Federal advances, plus interest earned, from the guarantee agencies; (2) propose legislation that will allow the Department to recover the 1976 advances, plus interest earned, from such agencies; and (3) provide for a letter of credit mechanism to strengthen guarantee agency reserves when such a need is demonstrated.

We believe that the GAO report should state that their conclusions and recommendations are similar to those expressed by the Office of Inspector General in the 1982 audit report.